



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

OFFICE OF  
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE LEGAL ADVICE

MEMORANDUM FOR JAMES C. FEE, JR.  
ASSOCIATE AREA COUNSEL  
(LARGE AND MID-SIZE BUSINESS)  
CC:LMSB:MHT:PHI  
ATTN: Trevor Ackerman

FROM: Carol Nachman  
Special Counsel  
Administrative Provisions & Judicial Practice Division  
CC:PA:APJP

SUBJECT: Statute of Limitations: Restricted Consent on Form 872

This Chief Counsel Advice responds to your request for advice concerning the effect of a restricted consent agreement on the assessment period under I.R.C. §§ 6501(h), (j), and (k). In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

Taxpayer =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Year 5 =

Year 6 =

Year 7 =

Year 8 =

Year 9 =

Year 10 =

Year 11 =

### ISSUES

(1) Whether the Internal Revenue Service (Service) can assess a deficiency attributable to the Year 1, Year 2, and Year 3 carryback years, when the three-year statute of limitations periods for the Year 6 and Year 7 loss years (giving rise to tentative carrybacks) have been extended by restricted consent agreements that do not reference the carryback years.

(2) Whether, under section 6501(k), the period is still open for assessing deficiencies for items unrelated to Taxpayer's losses carried back to Year 1, Year 2, and Year 3, where the restricted consent agreements for the loss years do not reference the unrelated items.

### CONCLUSIONS

(1) The periods for assessing deficiencies attributable to the Taxpayer's carryback years are still open, even though the restricted consent agreements do not reference the carryback years. The agreements extended the assessment periods for adjustments to the Taxpayer's Corporate Owned Life Insurance (COLI) deductions and any consequential changes arising from adjustments to those deductions. Consequential changes include items from carryback years.

(2) The periods are still open for assessing deficiencies for items unrelated to Taxpayer's carrybacks under section 6501(k). When assessment periods are extended for carrybacks, the assessment periods are similarly extended under section 6501(k).

### FACTS

Taxpayer is a corporation that files its tax returns on a fiscal year basis. In Year 10, the Service began examining Taxpayer's Year 4-Year 9 tax years; the primary concern was Taxpayer's COLI interest expense deductions. At the time of the examination, the Year 9 tax year was open, and it continues to be an open year (without restriction). The assessment period for the Year 4-Year 8 tax years (including the Year 6 and Year 7 loss years) had been extended by Forms 872, Consent to Extend the Time to Assess Taxes. On the Forms 872, the assessment

period for all five years had been extended until Year 11. Each Form 872 contains the below restricted language, for the appropriate calendar year:

(3) The amount of any deficiency assessment is to be limited to that resulting from any adjustment to deductions claimed by the taxpayer with respect to Corporate Owned Life Insurance (COLI) for the taxable year ended Year 4 and any consequential changes to other items based on such adjustment.

(4) For purposes of the provision of Section 6511(c) of the Internal Revenue Code of 1986, the refunds or credits which may be claimed under this agreement are limited to those resulting from any adjustments which are made pursuant to paragraph (3) above.

In Year 6 and Year 7, Taxpayer reported net operating losses (NOL) and carried the losses back to the three preceding tax years, i.e., Year 3, Year 4, and Year 5. The NOL carrybacks enabled Taxpayer to carry back general business credits to the Year 1, Year 2, and Year 3 tax years. Taxpayer timely filed Form 1139 applications for tentative carryback adjustments and received the following tentative refunds:

Year 1	--	\$
Year 2	--	\$
Year 3	--	\$

Taxpayer deducted COLI interest expenses, beginning in Year 1, and continuing through the Year 9 tax year. Because Forms 872 have not been executed for the Year 1, Year 2, and Year 3 tax years, you have asked us whether the Service can assess deficiencies for interest expense deductions related to the COLI investments for the Year 1, Year 2, and Year 3 tax years, up to the amount of the tentative refunds. The tentative refunds relate back to years covered in the restricted consent forms. The specific items from those years are NOL and credit carrybacks. The concern is whether, under the restricted consent agreements, the periods for assessing items unrelated to the NOL and credit carrybacks may have expired. The unrelated items are adjustments of COLI interest in the carryback years.

## LAW AND ANALYSIS

### Assessment

Section 6501(a) provides that, except as otherwise provided in section 6501, the amount of any tax shall be assessed within three years after the return was filed, whether or not such return was filed on or after the date prescribed.

Section 6501(c)(4) provides, in part, where, before the expiration of the prescribed period in section 6501 for the assessment of any tax, both the Service and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. In other words, the Service and a taxpayer may enter into a restricted consent to assess where both parties agree not only to the extended period in which to make an assessment but also to particular items that are assessable. If an item is not included in a restricted consent, then the statute of limitations will expire for that item. "The very purpose of a restricted consent is to tailor the extension of the limitations period to only those items agreed to by the taxpayer and the Commissioner." Foam Recycling Associates v. Commissioner, 98-2 U.S.T.C. ¶ 50,725 (2<sup>nd</sup> Cir. 1998). The Tax Court has characterized a restricted consent as a deal between the taxpayer and the Service. Ferguson v. Commissioner, T.C. Memo, 1992-451. If the Service strikes a bad deal with the taxpayer, the Service cannot unilaterally change it. Id.

Because the wording of the restricted consent is critical, the Internal Revenue Manual (IRM) provides guidance on the terms to be included in a restricted consent. To ensure that adjustments are given their full effect, IRM 25.6.22.8.12 recommends that a restricted consent include standard language allowing the Service to assess any consequential changes arising from an adjustment to an agreed upon item. The phrase "consequential changes" means any direct or indirect effect. For example, assume the principle issue subject to a restricted consent involves the allowability of an exemption for a claimed dependent. If the Service disallows the exemption, one possible direct consequence is the disallowance of any medical expenses claimed for the disallowed dependent. If this direct consequence reduces the total itemized deductions to the point that the standard deduction is greater, the disallowance of all itemized deductions and the allowance of the standard deduction would be an indirect consequence. Id.

Also, because an adjustment to an item in a restricted consent may affect other tax periods, IRM 25.6.22.8.10 and 25.6.22.5.5.1 provide that the month, day, and year should be shown for each tax period where the restricted consent is to cover more than one tax year. For example, the restricted consent would list the tax years as December 31, 1994 and December 31, 1995. Similarly, IRM 25.6.22.8.7(4) and (5) provide that additional language should be added to the Service's standard language when the Service intends that the restricted consent apply to multiple tax periods. The suggested additional language is that the restricted consent applies to "items affected by continuing tax effects caused by adjustments to any prior tax return." See IRM 25.6.22.8.7(4).

Although an agreement under section 6501(c)(4) is not a contract, contract principles are used to determine the existence and scope of the agreement. Kronish v. Commissioner, 90 T.C. 684, 693 (1988); Piarulle v. Commissioner, 80 T.C. 1035, 1042 (1983). After signing restricted consent agreements, taxpayers

have objected in the Tax Court to the notices of deficiency, arguing that the Service's deficiency exceeded the scope of the agreement. See Microsoft Corp. v. Commissioner, T.C. Memo 1998-54 ; Ferguson v. Commissioner, *supra*; Bauer v. Commissioner, T.C. Memo 1992-257; Goldberg v. Commissioner, T.C. Memo 1992-108. In Microsoft, Ferguson, Bauer, and Goldberg, the Tax Court strictly interpreted the plain wording of the agreements and held that the Service had exceeded the consent agreements by asserting deficiencies for items unrelated to the consent agreements.

### Extensions of the Assessment Period for Carryback Years

In the case of a deficiency attributable to the application of an NOL carryback, "such deficiency may be assessed at any time before the expiration of the period within which a deficiency for the taxable year of the net operating loss ... which results in such carryback may be assessed." I.R.C. § 6501(h). In other words, if the year in which the NOL arose is open for assessment, then the year to which the NOL is carried back is also open for purposes of assessing a deficiency attributable to the carryback. E.g., Mulder v. United States, 97-2 U.S.T.C. (CCH) ¶ 50,919 (Fed Cir. 1997). Under the extended limitations period of section 6501(h), the Service may assess a deficiency only to the extent that the deficiency is attributable to the application to the taxpayer of a loss carryback. E.g., Jones v. Commissioner, 71 T.C. 391, 397 (1978). Under subsection (h), the Service may not use the extended limitations period to assess a deficiency attributable to items unrelated to the loss carryback. Id.

A similar rule applies under section 6501(j) for credit carrybacks. That is, the period for assessing a deficiency for a credit carryback attributable to the application of an NOL carryback is open for as long as the period for making an assessment for the NOL year is open. See Herman Bennett Co. v. Commissioner, 65 T.C. 506, 509 (1975) (discussing the application of section 6501(j)).

Section 6501(k) provides, in part, that where an amount has been applied, credited or refunded under section 6411 (relating to a tentative carryback and refund adjustment) by reason of a NOL or credit carryback to a prior taxable year, the period described in section 6501(a) for assessing a deficiency for such prior taxable year shall be extended to include the period described in sections 6501(h) or (j), whichever is applicable; except that the amount which may be assessed solely by reason of this subsection shall not exceed the amount credited or refunded under section 6411, reduced by any amount which may be assessed under subsections (h) or (j). In other words, the periods of assessment under sections 6501(h) and (j) are still open to recover deficiencies attributable to the carryback, and the assessment period is still open to recover a deficiency that is unrelated to the carryback. In effect, by seeking a refund under section 6411, the taxpayer has opened the door so that the assessment period is open for items that are unrelated to the carrybacks. See Pesch v. Commissioner, 78 T.C. 100, 132-37 (1982);

Jones, supra, 71 T.C. at 396-98. The amount, however, that the Service may recover is limited to the amount erroneously refunded, reduced by amounts assessed under subsections (h) or (j).

The example in Proced. & Admin. Reg. § 301.6501(m)-1(a)(2) 1/ illustrates (1) how section 6501(k) opens the door to allow the Service to assert deficiencies that are not attributable to a carryback and (2) how the assessment period for the carryback year is also extended:

Assume that M corporation, which claims an unused investment credit of \$50,000 for the calendar year 1968, files an application under section 6411 of the Code for an adjustment of its tax year for 1965, and receives a refund in 1969. In 1971, it is determined that the amount of the unused investment credit for 1968 is \$30,000 rather than \$50,000. Moreover, it is determined that M Corporation would have owed \$40,000 of additional tax for 1965 if it had properly reported certain income which it failed to include in its 1965 return. Assuming that M Corporation filed its 1968 return on March 15, 1969, and that the 3-year period described in section 6501(a) has not been extended, the period prescribed in section 6501(j) for assessing the excessive amount refunded, \$20,000 (i.e., \$50,000, original amount refunded, less \$30,000, correct amount of unused investment credit), does not expire until March 15, 1972, and \$20,000 may be assessed on or before such date under section 6501(j). Under section 6501(m), M corporation may be assessed on or before March 15, 1972, an amount not in excess of \$30,000 (\$50,000, the amount refunded under section 6411, minus \$20,000, the amount that may be assessed solely because of section 6501(j)).

### The Restricted Consent Agreements

#### Sections 6501(h) and (j)

The first question is whether the restricted consents for the taxable years ending Year 6 and Year 7, the loss years, should be interpreted to mean that the assessment period is still open for asserting deficiencies in the carryback years (Year 1, Year 2, and Year 3) under sections 6501(h) and (j). 2/ Based on the

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1/ Section 6501(k) was originally designated as section 6501(m). In 1984, Congress redesignated section 6501(m) to section 6501(k). The references in the regulation to 6501(m) should now be read as referring to section 6501(k).

2/ The recovery under section 6501(k) cannot be determined without first calculating the "the amount that may be assessed solely by reason of subsection (h) or

restricted consent agreements, the assessment period is still open for the carryback years. The restricted consent agreements allow the Service to assert a deficiency for consequential changes arising from the disallowance of COLI interest expense deductions in the loss years.

The consent agreements do not specifically refer to NOL carrybacks, credit carrybacks, or carryback years. Nor do they include language stating that the restricted consent applies to more than one tax period. See IRM 25.6.22.8.10 and 25.6.22.5.5.1 (providing that the additional time period should be clearly identified). See also IRM 25.6.22.8.7(4) and (5) (providing that additional language, such as “items affected by continuing tax effects,” should be added when a restricted consent applies to multiple tax periods). Nevertheless, under the consent agreements, Taxpayer agreed that the assessment periods for carryback years were coterminous for the period giving rise to the loss.

In an analogous case, Schneer v. Commissioner, T.C. Memo 1993-372, the taxpayers and the Service entered into a restricted consent agreement for calendar year 1983 for losses related to operating a coal mine. Subsequently, the Service asserted a deficiency for the coal losses that had been carried back to 1980, 1981, and 1982, contending that the assessment period for those years was still open pursuant to section 6501(h). In litigation, the taxpayers argued that the period for assessments was closed for the carryback years (1980, 1981, and 1982) since the restricted consent agreement did not refer to NOL carrybacks. The Tax Court rejected their argument, reasoning that the plain wording of the restricted consent agreement provided for such assessments. Specifically, the restricted consent agreement stated, in part, that the assessment period was extended to “any deficiency” resulting from the claimed coal losses and any “consequential changes” to other items. The Tax Court interpreted the term “consequential changes” to include NOL carrybacks from the 1983 loss year. Thus, under Schneer, as long as the restricted consent agreement contains the Service’s standard language as to consequential changes and the assessment period is extended for a loss item, then the period is also extended for the carryback year. See also, Centennial Sav. Bank F.S.B. v. United States, 887 F.2d 595, 599 (5th Cir. 1989) aff’d in part and rev’d in part on other grounds, 499 U.S. 573 (1991) (The Fifth Circuit held, in part, that “when a taxpayer agrees under section 6501(c)(4) that the tax for the loss year may be assessed beyond the normal three year period, he is automatically extending the limitations period for the assessment of that loss as applied to the carryback years.”)

Given the case law support for consequential changes, we think the use of that phrase in the present case allows the Service to assert a deficiency for the carryback years under section 6501(h) and (j).

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(j).”

Section 6501(k) and Unrelated Items

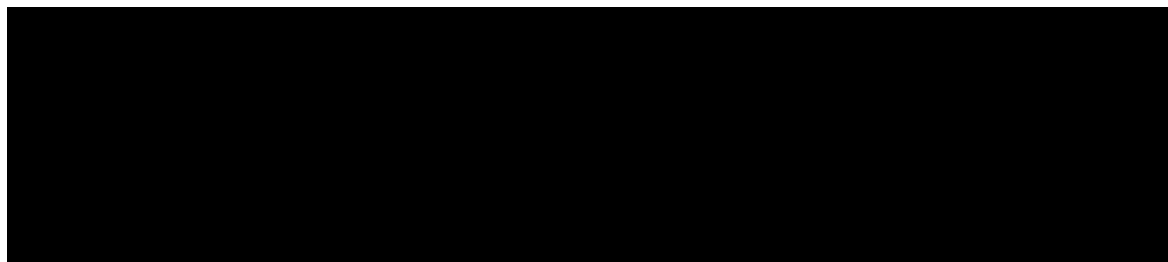
The next question is whether the restricted consents for the taxable years ending Year 6 and Year 7, should be interpreted to mean that the assessment period is still open for items unrelated to the carrybacks. Under the plain wording of section 6501(k), if the assessment period is open for a carryback year, the Service has the right to assert a deficiency for any item, regardless of whether the item is related to the carryback. The amount assessed, however, shall not exceed the refund, reduced by any amount assessed under subsections (h) and (j).

The legislative history of section 6501(k) supports the position that, when Congress enacted section 6501(k), it intended that the new section operate in conjunction with the existing provisions for extending the assessment period:

[A] deficiency for a year, with respect to which a quick refund was made because of a tentative carryback, may be assessed at any time up to 3 years after the return is filed for the taxable year in which the carryback arose (provided this period is not further extended by other provisions of sec. 6501; i.e., where there was fraud involved, etc.).

S. Rept. 1709, to accompany H.R. 11660 (Pub. L. 89-721), 89th Cong., 2d Sess. 4 (1966) (emphasis added). The other provision referred to in the legislative history includes restricted consents under section 6501(c)(4). Thus, Congress intended that, even when a taxpayer extended an assessment period by using the restricted consent provisions in section 6501(c)(4), section 6501(k) would still apply.

Keeping the assessment period open for items unrelated to the carrybacks gives full effect to the Congressional goal of recovering erroneous refunds arising from tentative carryback adjustments under section 6411. Specifically, Congress realized that the Service could not make a full audit within the accelerated time frame provided for examining a tentative carryback adjustment. See I.R.C. § 6411(b) (Service has 90 days within which to make a limited examination). Recognizing that there would be erroneous refunds in this situation, Congress provided extensions of the assessment period to recover the funds in subsections (h), (j), and (k).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS



[REDACTED]

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